

FDIC State Profile

Spring 2005

Puerto Rico and the U.S. Virgin Islands

During 2004, job growth in Puerto Rico and the U.S. Virgin Islands (USVI) exceeded the nation.

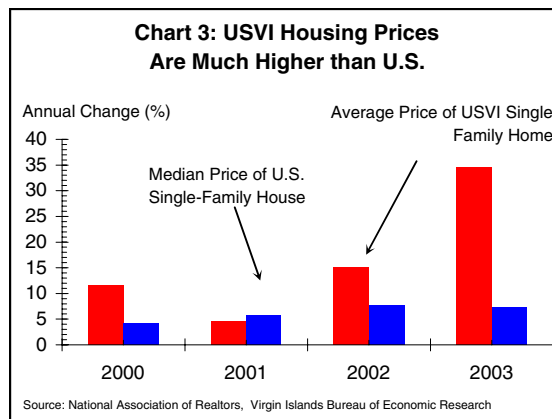
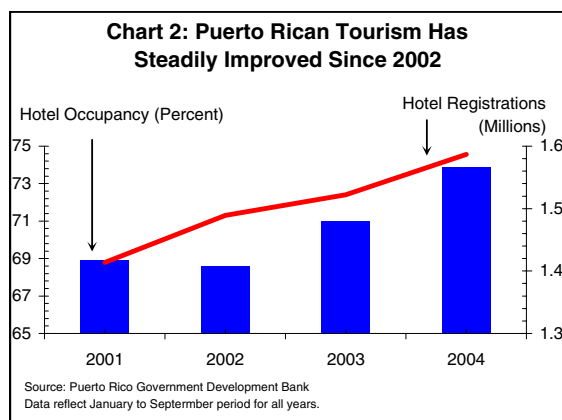
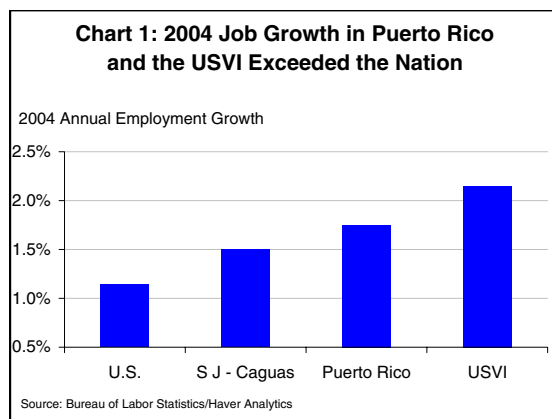
- **Puerto Rico** added approximately 18,000 new jobs in 2004, an increase of 1.75 percent. Although half its 2003 rate, Puerto Rico's 2004 job growth rate exceeded the U.S. average (See Chart 1).
- The **San Juan-Caguas** metropolitan area accounts for almost 75 percent of Puerto Rico's total employment base. During 2004, this area increased jobs by 1.5 percent. Improved tourism contributed to more hotel and retailing jobs. Reflective of an expanding economy, jobs were also added in the business services sector.
- The pharmaceutical industry is a leading employer in the San Juan-Caguas metropolitan area, as 16 of the top 20 pharmaceutical companies have operating facilities in Puerto Rico.¹ Because of global competition, however, pharmaceutical employment growth was flat in 2004.
- During 2004, **USVI** recorded its strongest job growth rate since 2001. Gains in the travel and leisure industry, a key component of USVI's economy, and business services were the primary contributors to the area's improved employment profile.

Puerto Rico's tourism sector continues to shine.

- Despite an increase of more than 500 rooms or 4 percent during the past three years, hotel registrations and occupancy rates in Puerto Rico have consistently improved (See Chart 2). A new \$415 million convention center near San Juan, potentially the largest meeting facility in the Caribbean, is scheduled to open in September 2005 and could strengthen Puerto Rico's tourism industry.

Puerto Rico's housing shortage has increased, while demand for luxury homes in the USVI has increased.

- Housing demand has outpaced supply in Puerto Rico. Reports indicate that the shortage of homes in Puerto Rico has doubled from 50,000 homes in 2001 to as many



¹Gibbs, Lennox and Di Re, John, The View From Puerto Rico – Ten Key Questions. CIBC World Markets – Equity Research Company Update, February 8, 2005.

as 100,000 homes, almost 7 percent of existing stock.² The housing shortage has led to estimated home price appreciation between 5 percent and 7 percent. Demand for second homes is also strong.

- Reflective of strong demand for luxury homes, USVI housing prices have increased greater than the United States (See Chart 3). Private residential permits rose 30 percent in 2003 and at a 60 percent annualized rate through the first six months of 2004, about three times the U.S. average. Reports suggest that there are additional luxury homes in the pipeline.

FDIC-insured institutions headquartered in Puerto Rico and the USVI reported higher profitability and improved credit quality measures in 2004.

- Return-on-assets reported by Puerto Rico and USVI institutions increased to 1.37 percent in 2004 from 1.16 in 2003.³ Lower net interest margins, a result of a flatter yield curve, were offset by a drop in provisions for loan losses amidst favorable credit quality. Loan delinquency and charge-off rates, while consistently higher than on the U.S. mainland, declined significantly across all loan categories in 2004.

Real estate lending is driving loan growth.

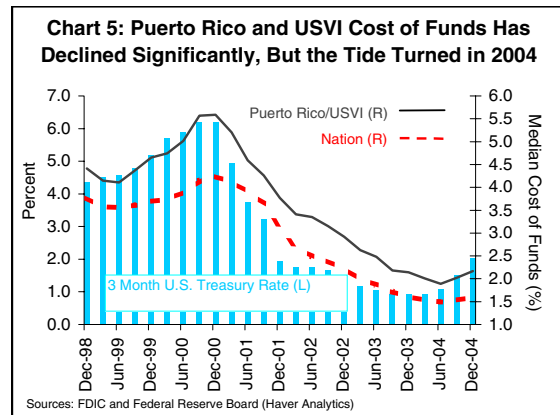
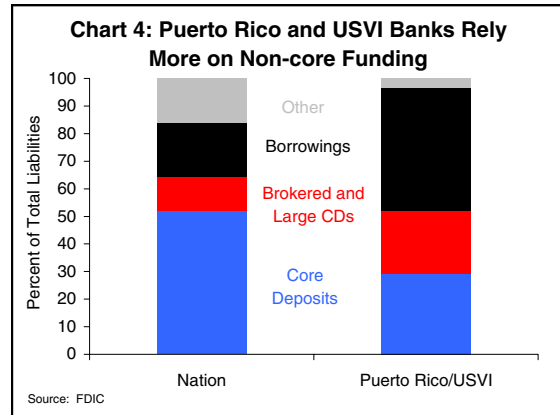
- At growth rates approaching 30 percent, commercial and residential real estate-related lending led loan growth in 2004, reflecting strong housing markets and improving economic conditions. Consistent with an expanding economy, commercial and industrial loans grew 17.1 percent following contraction in 2003.

Higher reliance on non-core funding may contribute to increased funding costs in a rising rate environment.

- Puerto Rico and USVI banks rely more on non-core funding, such as brokered deposits and borrowings (See Chart 4). Puerto Rico's and USVI's high reliance on non-core funding is largely the result of the competitive banking market and considerable "unbanked" population.⁴
- Non-core funds typically are more sensitive to changes in interest rates than core deposits. While a higher mix of non-core funds benefited Puerto Rico and USVI banks in the early 2000s, it recently has contributed to a more significant increase in funding costs amidst rising short-term interest rates (See Chart 5). In the second half

of 2004, the median cost of funds increased 28 basis points among Puerto Rico and USVI banks, compared with 11 basis points nationwide.

- A continuation of an improved economic outlook and strong housing markets should positively affect the local banking industry. However, should interest rates continue to rise, banks will face higher funding costs in 2005.



²Okusanya, II, Omatayo, Are Superior Stock Returns From San Juan Sustainable? UBS Investment Research – The Puerto Rican Banking Sector, January 10, 2005.

³Analysis is for community banks unless otherwise noted. "Community banks" are defined as insured institutions that hold less than \$1 billion in total assets. This definition excludes credit card banks and banks less than three years old.

⁴For information on recent trends in bank funding, see the FDIC Outlook – "In Focus This Quarter: Funding Asset Growth in a Rising Rate Environment: National and Regional Perspectives," Spring 2005, <http://www.fdic.gov/bank/analytical/regional/ro20051q/na/t1q2005.pdf>.

Puerto Rico and the U.S. Virgin Islands at a Glance

ECONOMIC INDICATORS (Change from year ago quarter, unless noted)

Employment Growth Rates	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Total Nonfarm (share of trailing four quarter employment in parentheses)	0.6%	4.6%	0.1%	-3.4%	2.0%
Manufacturing (11%)	-2.9%	2.5%	-5.5%	-13.0%	0.8%
Other (non-manufacturing) Goods-Producing (7%)	-5.7%	3.4%	-6.1%	-6.8%	5.2%
Private Service-Producing (53%)	0.5%	6.9%	0.0%	-3.4%	2.8%
Government (30%)	3.7%	1.7%	4.4%	2.7%	0.1%
Unemployment Rate (% of labor force)	10.6	11.9	12.0	11.7	9.9

BANKING TRENDS

General Information	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Institutions (#)	12	13	13	14	14
Total Assets (in millions)	93,687	78,275	67,160	59,615	52,408
New Institutions (# < 3 years)	0	0	0	1	1
Subchapter S Institutions	1	1	1	1	1

Asset Quality	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Past-Due and Nonaccrual Loans / Total Loans (median %)	4.35	4.80	5.26	5.95	4.80
ALLL/Total Loans (median %)	1.28	1.55	1.24	1.26	1.22
ALLL/Noncurrent Loans (median multiple)	0.55	0.62	0.40	0.45	0.55
Net Loan Losses / Total Loans (median %)	0.51	0.37	0.71	0.70	0.81

Capital / Earnings	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Tier 1 Leverage (median %)	6.79	6.78	6.79	6.42	6.30
Return on Assets (median %)	1.37	1.16	1.20	1.14	1.01
Pretax Return on Assets (median %)	1.65	1.37	1.38	1.31	1.29
Net Interest Margin (median %)	3.21	2.96	3.24	3.73	3.78
Yield on Earning Assets (median %)	4.98	5.35	6.48	7.77	8.73
Cost of Funding Earning Assets (median %)	2.00	2.36	3.19	4.31	5.26
Provisions to Avg. Assets (median %)	0.31	0.42	0.61	0.39	0.43
Noninterest Income to Avg. Assets (median %)	0.62	0.64	0.55	0.58	0.63
Overhead to Avg. Assets (median %)	2.12	2.23	2.48	2.41	2.57

Liquidity / Sensitivity	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Loans to Assets (median %)	54.4	55.0	53.2	58.5	59.1
Noncore Funding to Assets (median %)	59.1	59.7	61.6	61.9	62.4
Long-term Assets to Assets (median %, call filers)	40.1	39.9	23.4	31.1	35.6
Brokered Deposits (number of institutions)	9	10	10	11	11
Brokered Deposits to Assets (median % for those above)	11.3	13.7	15.7	10.2	6.4

Loan Concentrations (median % of Tier 1 Capital)	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Commercial and Industrial	82.1	143.3	159.3	161.8	176.2
Commercial Real Estate	175.6	194.0	221.4	215.1	227.7
Construction & Development	39.8	58.5	58.7	52.9	54.0
Multifamily Residential Real Estate	0.2	0.0	0.5	0.7	0.8
Nonresidential Real Estate	120.8	143.7	129.6	141.6	130.5
Residential Real Estate	251.7	306.0	203.1	205.0	196.2
Consumer	48.1	90.0	99.0	146.2	153.4
Agriculture	3.1	0.1	0.2	0.2	0.1

BANKING PROFILE

Largest Deposit Markets	Institutions in Market	Deposits (\$ millions)	Asset Distribution	Institutions
San Juan-Caguas-Guaynabo, PR	11	38,404	< \$250 mil.	2 (16.7%)
Ponce, PR	11	1,868	\$250 mil. to \$1 bil.	0 (0%)
Aguadilla-Isabela-San Sebastian, PR	7	1,132	\$1 bil. to \$10 bil.	6 (50%)
Mayaguez, PR	11	1,112	> \$10 bil.	4 (33.3%)
San German-Cabo Rojo, PR	4	637		